

Message Text

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ACTION EA-09

INFO OCT-01 ISO-00 ONY-00 CCO-00 ES-01 /011 W

-----250456 037566 /12-R

O 250410Z FEB 77

FM AMEMBASSY TOKYO

TO SECSTATE WASHDC IMMEDIATE 5690

C O N F I D E N T I A L TOKYO 2613

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FOR EA/J SHERMAN

E.O. 11652: GDS

TAGS: OVIP, JA

SUBJECT: FUKUDA VISIT PAPER: PROSPECTS FOR ECONOMIC STIMULUS

REF: STATE 33987

1. THE JAPANESE ECONOMY APPEARS TO HAVE BEEN EXPANDING AT ONLY 1-2 PERCENT ANNUAL RATE SINCE LAST SUMMER. BUT ON THE STRENGTH OF A STRONG EXPANSION IN THE FIRST HALF OF 1976, JAPAN SHOULD SHOW YEAR-ON-YEAR REAL GROWTH OF 5-1/2 TO 6 PERCENT. FOR THE COMING FISCAL YEAR (BEGINNING APRIL 1, 1977), THE GOVERNMENT IS AIMING AT A 6.7 PERCENT REAL GROWTH RATE, HIGH BY CURRENT INTERNATIONAL STANDARDS ALTHOUGH NOT BY EARLIER JAPANESE STANDARDS. INFLATION, RUNNING AT ABOUT A 9 PERCENT RATE, REMAINS HIGH; EVEN OFFICIAL GOJ FORECASTS PROJECT ONLY MODERATE FURTHER IMPROVEMENT IN THE COMING YEAR. JAPAN'S INTERNATIONAL TRADE AND SERVICES ACCOUNTS (CURRENT ACCOUNT), WHICH SHOWED A DOLS 3.7 BILLION SURPLUS IN 1976, ARE OFFICIALLY FORECAST TO MOVE INTO A SMALL DEFICIT THIS YEAR. ANY PROBABLE DETERIORATION, HOWEVER, IS STILL APT TO LEAVE JAPAN WITH A CURRENT ACCOUNT POSITION WHICH PLACES TOO MUCH OF THE BURDEN OF THE OPEC SURPLUS ON COUNTRIES IN A WEAKER POSITION SUCH AS THE U.K., ITALY
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AND THE OIL-IMPORTING LDCS.

2. FACING THE SLOWDOWN IN ECONOMIC RECOVERY, JAPAN HAS SINCE LAST NOVEMBER BEEN MOVING TOWARD MORE STIMULATIVE FISCAL POLICY. A STIMULUS PROGRAM ANNOUNCED IN NOVEMBER WAS FUNDED IN A DOLS 1.2 BILLION SUPPLEMENTAL BUDGET REQUEST IN DECEMBER (PLUS AN INCREASE IN GOVERNMENT

LENDING PROGRAMS) AND APPROVED BY THE DIET IN FEBRUARY. THE PROPOSED BUDGET FOR THE NEXT FISCAL YEAR (CURRENTLY UNDER DISCUSSION IN THE DIET BUT EXPECTED TO BE PASSED BY LOWER HOUSE--TANTAMOUNT TO ADOPTION--BEFORE THE PRIME MINISTER'S VISIT) EMBODIES A 17.4 PERCENT INCREASE IN OVERALL EXPENDITURES. IT ALSO PROVIDES FOR AN EVEN LARGER (21.4 PERCENT) INCREASE IN PUBLIC WORKS, WHICH THE GOVERNMENT PREFERS OVER TAX CUTS AS A MEANS OF ECONOMIC STIMULUS, A PREFERENCE POSSIBLY INFLUENCED BY THE LIBERAL DEMOCRATIC PARTY'S BUSINESS BACKING. THE BUDGET ALSO CALLS FOR A MODERATE TAX CUT (ABOUT DOLS 1-1/2 BILLION IN FISCAL YEAR 1977) AND A LARGE OVERALL BUDGET DEFICIT OF DOLS 29 BILLION.

3. WITH LOWER HOUSE ELECTIONS LAST DECEMBER AND UPPER HOUSE ELECTIONS TENTATIVELY SCHEDULED FOR EARLY JULY, JAPANESE STIMULATIVE ACTIONS TO DATE REFLECT THE VIEW THAT GROWTH IS GOOD POLITICS IN JAPAN. WHILE UNEMPLOYMENT, AT ABOUT 2 PERCENT, IS HIGH BY JAPANESE STANDARDS, IT DOES NOT PLACE HEAVY POLITICAL PRESSURES ON THE LDP; REAL PRESSURE FOR STIMULATIVE POLICIES COMES FROM A BUSINESS SECTOR ACCUSTOMED TO WORKING OFF ITS EXCESSES IN A HIGH GROWTH ENVIRONMENT. IN ANY CASE, THE GOVERNMENT OF JAPAN HAS FOR DOMESTIC REASONS BEEN VERY PLEASED TO RESPOND POSITIVELY TO U.S. CALLS FOR THE U.S., GERMANY AND JAPAN TO LEAD THE WAY TOWARD SUSTAINED WORLD ECONOMIC RECOVERY. IN A PRE-ELECTION PERIOD, PRIME MINISTER FUKUDA MUST, HOWEVER, ALSO TAKE INTO ACCOUNT TWO RECENT POLLS SHOWING THAT THE MOST IMPORTANT THING THE JAPANESE

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CITIZENRY WANTS FROM ITS GOVERNMENT IS PROGRESS IN CONTROLLING INFLATION.

4. THE ADEQUACY OF THE FISCAL STIMULUS PROGRAM TO DATE REMAINS TO BE SEEN. WITHIN JAPAN THERE IS SUBSTANTIAL CRITICISM OF THE PROGRAM, ALTHOUGH MUCH OF THIS CRITICISM (APART FROM POLITICALLY MOTIVATED CRITICISM) MAY REFLECT HIGHLY LEVERAGED JAPANESE INDUSTRIES' HOPE THAT SUCH CRITICISM WILL LEAD TO FURTHER RELAXATION OF MONETARY POLICY--AND IN PARTICULAR TO LOWER INTEREST RATES FOR BUSINESS BORROWING. OVERALL, GOVERNMENT FISCAL POLICY HAS TO BE JUDGED AS MORE THAN MODERATELY EXPANSIONARY. HOWEVER, PRIVATE INVESTMENT SHOWS LITTLE SIGN OF A STRONG RECOVERY; AND THIS LACK OF VITALITY COMBINES WITH THE RISK THAT THE INFLATION RATE WILL INCREASE AND CUT INTO REAL CONSUMER SPENDING TO MAKE IT MORE LIKELY THAT JAPAN WILL FALL SHORT OF ITS GROWTH TARGET THAN THAT IT WILL EXCEED IT. HOWEVER, SHOULD THEY BE APPEARING TO FALL SERIOUSLY SHORT OF THEIR TARGET, THE GOVERNMENT WOULD PROBABLY CONTEMPLATE FURTHER ACTION.

5. THE IMMEDIATE FOCUS OF ATTENTION IN JAPAN IS ON THE POSSIBILITY OF INCREASING THE FY 1977 TAX CUT FROM THE GOVERNMENT-PROPOSED DOLS 1-1/2 BILLION TO DOLS 3-1/2 BILLION (YEN 1 TRILLION), AS ADVOCATED BY ALL THE OPPOSITION PARTIES. THERE HAVE BEEN SOME SIGNALS THAT THE GOVERNMENT MIGHT BE PREPARED TO COMPROMISE WITH THE OPPOSITION. WHETHER SUCH A COMPROMISE WOULD TAKE THE FORM OF A TAX CUT LARGER THAN PRESENTLY PROPOSED (BUT PRESUMABLY LESS THAN YEN 1 TRILLION) OR SOME OTHER FORM, SHOULD BE CLEAR BY THE TIME OF THE PRIME MINISTER'S VISIT.

6. BECAUSE OF THE VERY LARGE BUDGET DEFICIT, FURTHER MAJOR EXPANSIONARY ACTION LATER IN THE YEAR, IF IT SEEMED REQUIRED, WOULD LIKELY FOCUS ON MONETARY POLICY. ONCE THE JULY UPPER HOUSE ELECTIONS ARE OUT OF THE WAY, THE GOVERNMENT WILL HAVE CONSIDERABLY MORE LEEWAY TO REDUCE

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INTEREST RATES AND IMPROVE BUSINESS PROFITABILITY. AT PRESENT, THE GOVERNMENT IS LIMITED IN ITS ABILITY TO LOWER BANK LENDING RATES SUBSTANTIALY WITHOUT A PARALLEL REDUCTION IN INTEREST RATES PAID ON POSTAL SAVINGS DEPOSITS--A SENSITIVE POLITICAL QUESTION--ALTHOUGH A MODEST EASING OF LENDING RATES SEEMS TO BE IN THE OFFING. SHOESMITH

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Message Attributes

Automatic Decaptioning: Z
Capture Date: 01-Jan-1994 12:00:00 am
Channel Indicators: n/a
Current Classification: UNCLASSIFIED
Concepts: ECONOMIC REPORTS
Control Number: n/a
Copy: SINGLE
Sent Date: 25-Feb-1977 12:00:00 am
Decaption Date: 22 May 2009
Decaption Note: 25 YEAR REVIEW
Disposition Action: RELEASED
Disposition Approved on Date:
Disposition Case Number: n/a
Disposition Comment: 25 YEAR REVIEW
Disposition Date: 22 May 2009
Disposition Event:
Disposition History: n/a
Disposition Reason:
Disposition Remarks:
Document Number: 1977TOKYO02613
Document Source: CORE
Document Unique ID: 00
Drafter: n/a
Enclosure: n/a
Executive Order: GS
Errors: N/A
Expiration:
Film Number: D770065-0315
Format: TEL
From: TOKYO
Handling Restrictions:
Image Path:
ISecure: 1
Legacy Key: link1977/newtext/t1977027/aaaaagaj.tel
Line Count: 146
Litigation Code IDs:
Litigation Codes:
Litigation History:
Locator: TEXT ON-LINE, ON MICROFILM
Message ID: 8fec0fcb-c288-dd11-92da-001cc4696bcc
Office: ACTION EA
Original Classification: CONFIDENTIAL
Original Handling Restrictions: ONLY
Original Previous Classification: n/a
Original Previous Handling Restrictions: n/a
Page Count: 3
Previous Channel Indicators: n/a
Previous Classification: CONFIDENTIAL
Previous Handling Restrictions: ONLY
Reference: 77 STATE 33987
Retention: 0
Review Action: RELEASED, APPROVED
Review Content Flags:
Review Date: 14-Feb-2005 12:00:00 am
Review Event:
Review Exemptions: n/a
Review Media Identifier:
Review Release Date: n/a
Review Release Event: n/a
Review Transfer Date:
Review Withdrawn Fields: n/a
SAS ID: 3399168
Secure: OPEN
Status: NATIVE
Subject: FUKUDA VISIT PAPER: PROSPECTS FOR ECONOMIC STIMULUS
TAGS: OVIP, ECON, JA, (FUKUDA, TAKEO)
To: STATE
Type: TE
vdkgvwkey: odhc://SAS/SAS.dbo.SAS_Docs/8fec0fcb-c288-dd11-92da-001cc4696bcc
Review Markings:
Margaret P. Grafeld
Declassified/Released
US Department of State
EO Systematic Review
22 May 2009
Markings: Margaret P. Grafeld Declassified/Released US Department of State EO Systematic Review 22 May 2009